

Internal Revenue Service

Department of the Treasury Date 9/24/96

Washington, DC 20224

Surname [REDACTED]

9/25/96

Person to Contact: [REDACTED]

Telephone Number:

(202) [REDACTED]

Refer Reply to:

(202) [REDACTED]

Date:

CP:E:EO:T:1:JJO

AUG 7 1996

Employer Identification Number: [REDACTED]

Key District : Southeast (Baltimore, MD)

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax as an organization described in section 501(c)(9) of the Internal Revenue Code. Based on the information submitted, we have concluded that you do not qualify for exemption under that section.

FACTS

[REDACTED] ("Trust") was created in the State of [REDACTED] under a Trust Agreement dated [REDACTED]. On [REDACTED], the Trust Agreement was restated. You represent that the purpose for restating the Trust Agreement was to ensure that the Trust was in compliance with the requirements of the Employee Retirement Income Security Act of 1974 and amendments thereto ("ERISA") and to meet the original intent of the Trust being a tax-exempt organization, including being subject to Wisconsin law that favors tax-exempt status for multiple-employer welfare arrangements.

The restated Trust Agreement provided that the Trust was created under the laws of the State of Wisconsin, and that all questions pertaining to its validity, construction and administration shall be determined in accordance with the laws of the State of Wisconsin, except to the extent governed or preempted by the constitutional laws of the United States. The Trust Agreement further provided that venue for any action arising under the Trust or pursuant to any Employee Welfare Benefit Plan or Plans adopted pursuant to the Trust shall lie in [REDACTED].

The Trust was established for the purpose of enabling participating employers to arrange for the provision of health care services and benefits, disability benefits, death benefits,

[REDACTED]

accident benefits, and benefits required by applicable state workers' compensation laws, for those persons who from time to time are determined in accordance with the provisions of a related Benefit Plan to be eligible employees or beneficiaries or dependents of eligible employees. You represent that the workers' compensation benefits are an important and prominent part of the benefit package offered by the Benefit Plan. Any employer which is a member in good standing of the [REDACTED] ("Association") may become a participating employer in the Benefit Plan.

Membership in the Association is limited to the small entrepreneur-employer typically having fewer than 100 employees. The Association contracts with individuals to solicit participation in the Association and participation in the Benefit Plan. The Trust does not itself independently solicit membership. The Association is marketed through salesmen or enrollers who are paid on a commission basis. You represent that the Trust presently provides benefits to businesses in 21 states and is composed of approximately [REDACTED] employer-members who in turn have approximately [REDACTED] employees. You make no representation with regard to the participants of the Trust as to a collective bargaining agreement, or union representation by either a national or international labor union.

The principal source of funding of the Trust is premiums contributed by Association members which are transferred to the Trust to provide the benefits to the participating members and their eligible employees. Temporary excesses of premiums over benefits provided are invested in various financial instruments. The returns from these temporary investments provide financial support for the Trust to carry out its purpose.

APPLICABLE LAW

Section 501(a) of the Internal Revenue Code exempts, in pertinent part, organizations described in section 501(c).

Section 501(c)(9) of the Code describes voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-1 of the Income Tax Regulations provides that to be described in section 501(c)(9) an organization must meet all of the following requirements: (a) the organization must

[REDACTED]

be an employees' association; (b) membership in the organization must be voluntary; (c) the organization must provide life, sick, accident or other benefits to its members or their dependents or designated beneficiaries, and substantially all of its operations are in furtherance of providing such benefits; and (d) no part of the net earnings may inure to the benefit of any individual, other than through the payment of benefits.

Section 1.501(c)(9)-2(a)(1) of the regulations provides that an organization described in section 501(c)(9) must consist of individuals who become entitled to participate by reason of their being employees and whose eligibility for membership is defined by reference to objective standards that constitute an employment-related common bond among such individuals. Typically, those eligible for membership in an organization described in section 501(c)(9) are defined by reference to a common employer (or affiliated employers), to coverage under one or more collective bargaining agreements, to membership in a labor union, or to membership in one or more locals of a national or international labor union. In addition, the regulation provides that employees of one or more employers engaged in the same line of business in the same geographic locale will be considered to share an employment-related bond for purposes of an organization through which their employers provide benefits. The section further provides that whether a group of individuals is defined by reference to a permissible standard or standards is a question to be determined with regard to all the facts and circumstances, taking into account the guidelines set forth in this paragraph.

In National Muffler Dealers Association, Inc. v. United States, 440 U.S. 472 (1979), the Court at pp. 482-83 interpreted the phrase "line of business" in the context of section 501(c)(6) of the Code to mean either an entire industry or all components of an industry within a geographic area.

In United States v. Continental Can Co., 378 U.S. 441, 444 n. 2 (1964), the term 'industry' had previously been defined by the Court as follows:

The word 'industry' is susceptible of more than one meaning. It might be defined in terms of end uses for which various products compete; so defined it would be roughly equivalent to the concept of a 'line of commerce...' On the other hand, 'industry' might also denote an aggregate of enterprises employing similar production and marketing facilities and producing products having markedly similar characteristics. In

many instances, the segments of economic endeavor embraced by these two concepts of 'industry' will be substantially coextensive, since those who employ the same types of machinery to turn out the same general product often compete in the same market.

In Water Quality Association Employees' Benefit Corporation v. U.S., 795 F.2d 1303 (1986), the Seventh Circuit Court of Appeals reversed the District Court and held invalid the requirement of section 1.501(c)(9)-2(a)(1) of the regulations that organizations composed of employees of several unaffiliated employers must share the same geographic locale. Notwithstanding a decision that was otherwise adverse to the Government, at p. 1310 the Court states as follows:

That the quintessential element of a section 501(c)(9) tax-exempt VEBA is the commonality of interests among its employee members is not disputed. An association of unrelated individuals scattered throughout the country plainly would not fall within the scope of section 501(c)(9) though its membership is comprised entirely of employees because there is no "employment related common bond" among such individuals.

In 1992, the Service proposed an amendment to section 1.501(c)(9)-2 of the regulations. The proposed amendment would add new paragraph (d), which defines geographic locale as follows:

(d) Meaning of geographic locale -- (1) Three-state safe harbor. An area is a single geographic locale for purposes of paragraph (a)(1) of this section if it does not exceed the boundaries of three contiguous states, i.e., three states each of which shares a land or river border with at least one of the others. For this purpose, Alaska and Hawaii are deemed to be contiguous with each other and with each of the following states: Washington, Oregon and California.

(2) Discretionary authority to recognize as geographic locales. In determining whether an organization covering employees of employers engaged in the same line of business is a voluntary employees' beneficiary association (VEBA) described in section 501(c)(9), the Commissioner may recognize an area that does not satisfy the three-state safe harbor in paragraph (d)(1) of this section as a single geographic locale if --

(i) It would not be economically feasible to cover employees of employers engaged in that line of business in that area under two or more separate VEBAs each extending over fewer states; and

(ii) Employment characteristics in that line of business, population characteristics, or other regional factors support the particular states included. This paragraph (d)(2)(ii) is deemed satisfied if the states included are contiguous.

Rev. Rul. 74-18, 1974-1 C.B. 139, held that an association formed by a corporation to provide workmen's compensation benefits that the corporation was already obligated to pay under State law does not qualify for exemption under section 501(c)(9) of the Code.

RATIONALE

Section 1.501(c)(9)-2(a)(1) of the Income Tax Regulations requires a VEBA to have a membership composed of individuals who have an employment-related common bond. This requirement can be met in a number of ways, and the determination of whether an employment-related common bond exists is made taking into account all the facts and circumstances. The regulation provides that the employment-related common bond is typically defined by reference to a common employer (or affiliated employers), coverage under one or more collective bargaining agreements, or membership in a labor union or one or more locals of a national or international labor union. In addition, the regulation provides that employees of one or more employers engaged in the same line of business in the same geographic locale will be considered to share an employment-related bond for purposes of an organization through which their employers provide benefits. You do not satisfy any of these criteria.

The Trust provides benefits to eligible employees of unrelated employers and their beneficiaries or dependents in accordance with the provisions of a related Benefit Plan. Other than being members of the Association and participants in the Benefit Plan, there is no reference to a common employer (or affiliated employers) that serves as an employment-related common bond among your members.

Further, you make no representations nor do you provide any evidence as to the existence of a collective bargaining agreement or as to membership in a labor union or one or more locals of a national or international labor union.

[REDACTED]

The Trust serves unaffiliated employers. You have not shown that these employers are in the same line of business in addition to sharing the same geographic locale, for purposes of determining whether an employment-related common bond exists under section 1.501(9)(a)(2) of the regulations. In National Muffler Dealers Association, Inc. v. United States and United States v. Continental Can, supra, the term 'line of business' was interpreted to mean an entire industry or all components of an industry within a geographic area, and the word 'industry' was defined to mean either a group of businesses competing in the same market or an aggregate of enterprises employing similar production and marketing facilities and producing products having markedly similar characteristics. You have not shown that the members of the Trust are all in the same industry or that they have the required similar characteristics. Thus, your representation that the Trust provides benefits to businesses in 21 states and is composed of approximately 275 diverse employer-members who in turn have approximately 16,000 employees nullifies any argument that the employers are operating in the same line of business in the same geographic locale. The Trust satisfies neither the safe harbor standard set forth in paragraph (d)(1) nor the standard set forth in paragraph (d)(2) of the 1992 proposed amendment to section 1.501(c)(9)-2 of the regulations.

You suggest that the small business members (less than 100 employees) of the Trust otherwise share an employment-related common bond by virtue of their small size and their common need of insurance coverage. We do not believe that your arguments are persuasive. Employees of such businesses have too remote a connection to be defined by reference to objective standards that constitute an employment-related common bond. They share neither a common employer nor are they related in any manner suggested by the regulations, nor do they share any other affinity sufficient to satisfy the employment-related common bond requirement of the regulations. To allow these small business employers to qualify for exemption under section 501(c)(9) of the Code would be to disregard the limiting effect of section 1.501(c)(9)-2(a)(1) of the regulations.

In addition, one of the benefits provided by the Trust in accordance with the provisions of the related Benefit Plan is workers' compensation coverage. This coverage is a substantial part of your benefit package, and the participating employers are already obligated to provide this coverage to their employees under applicable state workers' compensation laws. Rev. Rul. 74-18, supra, provides that such an arrangement disqualifies an organization from qualifying under section 501(c)(9) of the Code.

[REDACTED]

Accordingly, based upon all the facts and circumstances of this case, you do not qualify for exemption from taxation under section 501(c)(9) of the Internal Revenue Code. You are, therefore, required to file federal income tax returns.

You have the right to protest our ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days of the date of this letter and must be signed by one of your officers. You also have the right to a conference in this office. Per your agreement, this conference took place on June 26, 1995.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your Key District Director. Thereafter, if you have any questions about your federal income tax status, including questions concerning reporting requirements, please contact your key District Director.

You will expedite our receipt of your protest statement by using the following address on the envelope: Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224, CP:E:EO:T:1, Room 6516.

Sincerely yours,

[REDACTED]
[REDACTED]
Chief, Exempt Organizations
Technical Branch 1

bcc: [REDACTED]
[REDACTED]

CP:E:EO:T:1 CP:E:EO:R CC:EBEC:4 CC:EBEC:11 CP:E:EO:R

0 7/11/96 7-11-96 7/11/96 7/21/96 8-5-96